DEPARTMENT OF STATE REVENUE

04-20130283.LOF

Letter of Findings: 04-20130283
Sales and Use Tax
For the Year 2010

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ISSUES

I. Sales and Use Tax – Agricultural Exemptions.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-3-4; IC § 6-2.5-5-2; IC § 6-8.1-5-1; 45 IAC 2.2-5-1; 45 IAC 2.2-5-4; 45 IAC 2.2-5-6; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974).

Taxpayer protests the assessment of tax on his purchases of tangible personal property.

II. Tax Administration – Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer, an Indiana land owner, rented his land to a farmer. Pursuant to a farming agreement, Taxpayer prepares the field for the tenant-farmer, who plants and harvests crops, such as corn and soybeans.

In 2010, Taxpayer purchased a John Deere Tractor ("Tractor") and a snow blower at a local store. Pursuant to a desk audit, the Indiana Department of Revenue ("Department") discovered that Taxpayer did not pay sales tax at the time of the purchases nor did Taxpayer self-assess and remit use tax to the Department. As a result, the Department assessed Taxpayer additional tax, interest, and penalty.

Taxpayer only protests the assessment of use tax on the Tractor. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales and Use Tax – Agricultural Exemptions.

DISCUSSION

The Department's audit assessed Taxpayer use tax on his purchase of the Tractor because Taxpayer did not pay sales tax at the time of the transaction, nor did he self-assess and remit the use tax to the Department. Taxpayer, to the contrary, claimed that he is entitled to the agricultural exemption found in IC § 6-2.5-5-2.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes a sales tax on retail transactions and a complementary use tax on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. Generally, all purchases of tangible personal property by persons engaged in the direct production, extraction, harvesting, or processing of agricultural commodities are taxable. 45 IAC 2.2-5-6(a). An exemption from use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional exemptions from sales tax and use tax. A statute which provides a tax exemption, however, is strictly construed against the taxpayer. Indiana Dep't of State Revenue v. RCA Corp., 310 N.E.2d 96, 97 (Ind. Ct. App. 1974).

IC § 6-2.5-5-2 states:

(a) Transactions involving **agricultural machinery, tools, and equipment** are exempt from the state gross retail tax if the person acquiring that property acquires it for his **direct use in the direct production**, extraction, harvesting, or processing **of agricultural commodities**.

(b) Transactions involving agricultural machinery or equipment are exempt from the state gross retail tax if:

(1) the person acquiring the property acquires it for use in conjunction with the production of food and food ingredients or commodities for sale;

(2) the person acquiring the property is occupationally engaged in the production of food or commodities which he sells for human or animal consumption or uses for further food and food ingredients or commodity production; and

(3) the machinery or equipment is designed for use in gathering, moving, or spreading animal waste.

(**Emphasis added**).

45 IAC 2.2-5-1(a) further provides:

Definitions. "Farmers" means only those persons **occupationally engaged in producing food or agricultural commodities for sale or for further use in producing food or such commodities for sale**. These terms are limited to those persons, partnerships, or corporations regularly engaged in the commercial production for sale of vegetables, fruits, crops, livestock, poultry, and other food or agricultural products. Only those persons, partnerships, or corporations whose intention it is to produce such food or commodities at a profit and not those persons who intend to engage in such production for pleasure or as a hobby qualify within this definition.

"Farming" means engaging in the commercial production of food or agricultural commodities as a farmer.

"To be directly used by the farmer in the direct production of food or agricultural commodities" requires that the property in question must have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces food or an agricultural commodity. (**Emphasis added**).

45 IAC 2.2-5-4, in relevant part, further illustrates:

(c) The following is a partial list of items which are considered subject to the sales tax.

TAXABLE TRANSACTIONS

Fences, posts, gates, and fencing materials.
Water supply systems for personal use.
Drains.
Any motor vehicle which is required by the motor vehicle law to be licensed for highway use.
Ditchers and graders.
Paints and brushes.
Refrigerators, freezers, and other household appliances.
Garden and lawn equipment, parts, and supplies.
Electricity for lighting and other non-agricultural use.
Any materials used in the construction or repair of non-exempt: buildings, silos, grain bins, corn cribs, barns, houses, and any other permanent structures.
Items of personal apparel, including footwear, gloves, etc., furnished primarily for the convenience of the workers if the workers are able to participate in the production process without it.
Pumps.
All saws.
All tools, including forks, shovels, hoes, welders, power tools, and hand tools.
Building materials or building hardware such as lumber, cement, nails, plywood, brick, paint.
Plumbing, electrical supplies, and accessories, pumps.
Horses, ponies, or donkeys not used as draft animals in the production of agricultural products.
Food for non-exempt horses, ponies, etc.
Fertilizer, pesticides, herbicides, or seeds to be used for gardens and lawns.
Field tile or culverts.
Graders, ditchers, front end loaders, or similar equipment (except equipment designed to haul animal waste).
Any replacement parts or accessories for the above items.

(d) Each of the following items is considered **exempt from the sales tax ONLY** when the purchaser is **occupationally engaged in agricultural production** and **uses** the items **directly in direct production of agricultural products**.

EXEMPT TRANSACTIONS

(1) Livestock and poultry sold for raising food for human consumption and breeding stock for such purposes.
(2) Feed and medicines sold for livestock and poultry described in Item (1).
(3) Seeds, plants, fertilizers, fungicides, insecticides, and herbicides.
(4) Implements used in the tilling of land and harvesting of crops therefrom, including tractors and attachments.
(5) Milking machines, filters, strainers, and aerators.
(6) Gasoline and other fuel and oil for farm tractors and for other exempt farm machinery.
(7) Grease and repair parts necessary for the servicing of exempt equipment.
(8) Containers used to package farm products for sale.
(9) Equipment designed to haul animal waste.
(10) Equipment such as needles, syringes, and vaccine pumps.

(e) **The fact that an item is purchased for use on the farm does not necessarily make it exempt from sale** [sic] **tax**. **It must be directly used by the farmer in the direct production of agricultural products**. The property in question must have an **immediate effect on the article being produced**. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces agricultural products. **The fact that a piece of equipment is convenient, necessary, or essential to farming is insufficient in itself to determine if it is used directly in direct production as required to be exempt**. (**Emphasis added**).

At the hearing, Taxpayer stated that he purchased the Tractor solely to be used on the farm. Taxpayer first stated that, under the farming agreement between him and his tenant-farmer, he is required to chop down stalks after the harvest of corn crops in the fall. Taxpayer also asserted that he is required to remove rocks and tire compaction on the farm in the following spring, so his tenant-farmer can plant the crops. Additionally, Taxpayer explained that one portion of his farm is set aside by the Agricultural Stabilization and Conservation Service ("ASCS"), and he is responsible for mowing the field to prevent trees from growing. Thus, Taxpayer maintained that he is entitled to the agricultural exemption on the purchase of the Tractor.

The Department must respectfully disagree. First, Taxpayer failed to demonstrate that he is occupationally engaged in agricultural production. Second, pursuant to the above mentioned statutes and regulations, all purchases of tangible personal property by persons engaged in the direct production, extraction, harvesting, or processing of agricultural commodities are taxable, unless the use of the tangible personal property satisfies the "double-direct" test; the equipment at issue must be involved in the direct production of the agricultural commodity and must have a direct effect upon that commodity. Taxpayer's documentation demonstrates that he used the Tractor (1) to chop the corn stalks after the harvest of that year, (2) remove rocks or tire compaction before planting the crop for the following year, and (3) to mow the field to prevent trees from growing. Thus, the Tractor was used after and/or before the direct production of the agricultural commodity, i.e., not during the direct agricultural production process. Thus, the Tractor did not have a direct effect upon the commodity.

Since Taxpayer did not pay sales tax at the time of the purchase, the use tax is properly imposed.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Negligence Penalty.

DISCUSSION

Taxpayer also protests the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

(1) fails to file a return for any of the listed taxes;

(2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

(4) fails to timely remit any tax held in trust for the state; or

(5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.

45 IAC 15-11-2(b) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in 45 IAC 15-11-2(c), in part, as follows:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

(1) the nature of the tax involved;

(2) judicial precedents set by Indiana courts;

(3) judicial precedents established in jurisdictions outside Indiana;

(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;

(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Taxpayer has provided sufficient documentation establishing that his failure to pay tax or timely remit tax was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest on the imposition of the negligence penalty is sustained.

SUMMARY

For the reasons discussed above, Taxpayer's protest of the assessment of use tax on his purchase of tangible personal property is respectfully denied. Taxpayer's protest of the imposition of the negligence penalty is sustained.

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